Transportation Insurance on Contract Liability and Brokers Liability

This paper addresses current insurance market challenges related to existing and emerging risks in the transportation industry, including contractual liability, brokers' liability and the impact of emerging technology such as artificial intelligence, blockchain and smart contracts.

To say that the insurance industry, and in particular the transportation insurance industry, is at a crossroads would be an understatement. The truth of the matter is that the transportation insurance industry is at the edge of a cliff and an autonomous electric semi-trailer truck, loaded with 80,000 lbs. of cargo, is driving straight at us, accelerating to 60 mph in less than 20 seconds.

The good news is that because the semi has advanced autopilot there is a 99.9% chance that it is not going to hit us. However, unless we acknowledge and grapple with the changes that are taking place, the transportation insurance industry will miss the opportunity to respond to the evolving needs of both existing and new clients that the semi represents.

Looking at the insurance industry as a whole, the financial fundamentals remain weak, with an over-supply of capacity that is being poorly deployed and not generating adequate returns to address the changing risk patterns. Rather than responding to changes in risk by addressing the underlying rating structure, insurers have been moving away from challenging exposures. Meanwhile, emerging technology and the shifting risk profiles that autonomous vehicles bring create additional underwriting uncertainty with the backdrop of the reptile plaintiff philosophy.

In addition to weak financials, the insurance industry's product delivery process is highly inefficient, documentation issuance is antiquated and ineffective, and our value proposition is not well understood by our clients. The barriers to entry into our industry have been created through outdated legislation, originally intended to protect the consumer, but currently only serving to make it more challenging for others in the financial services industry or in the technology space to disrupt the way insurance business is currently done. Already penetrating the personal lines space, insurance direct writers and the banks have found a significant opportunity to improve upon the traditional delivery model and capture a growing share of the market, and there is very little to suggest that this will not migrate into the commercial space as well.

Looking specifically at the transportation space, three important areas of focus that will impact transportation clients over the next five years are:

1. **Contractual liability**
   How shippers' attitudes towards carriers' liability for the transportation of cargo is changing.

2. **Brokers' liability**
   The impact that the growth of asset-light and non-asset logistics operations is having on automobile liability cases, along with how the insurance industry is responding to this.

3. **Changing technology**
   The introduction of new technologies to both the insurance and the transportation industry will have a significant impact on the fundamentals of the insurance industry.

CONTRACTUAL LIABILITY

Liability for the carriage of cargo is governed by the bill of lading. The bill of lading ensures there is clarity as to liability for loss or damage to cargo, and generally allows the carrier to limit their liability for certain types of perils and to certain maximum dollar amounts. The concept of limitation of liability of the carrier is one of the foundations of traditional cargo and stems back to when the movement of cargo was considered to be an "adventure" as opposed to an expectation. Over the years, aspects of carriers' limitation of liability, including the concept of General Average, have been challenged. Shippers are no longer aligned with seeing the carrier's transportation of their cargo as an "adventure" and, as such, are not as willing to accept and, in many cases, even bother to understand limitations of liability.

This is being addressed through a dramatic increase in shipper designed contracts governing the movement of cargo. Although shipper contracts started out as something that were primarily coming from the large box store retailers, it is now fairly common even among smaller shippers.

There are a variety of challenges with these custom shipper/carrier or shipper/broker contracts. Outside of just the basic construction of these contracts, which are often based on supply contracts rather than shipping agreements, from an insurance perspective there are a number of issues of which carriers and brokers need to be aware – and that would be beneficial for the lawyers assisting shippers with the construction of these agreements to consider.

First, open-ended liability provisions are difficult to insure. While underwriters are becoming more accustomed to seeing challenging shipper/carrier or shipper/broker contracts, the most difficult issue to address in an open ended contract is the financial impact of the contract on the carrier or broker. It should be remembered that a cargo liability policy has its foundation in standard limitation of liability, without an understanding of the potential financial impact of the contract, pricing insurance coverage for an open-ended contract is almost impossible.

With this in mind, carriers and brokers need to focus on the following clauses when considering whether a contract will be accepted by their cargo liability underwriters:

a. **Cargo Loss or Damage**
   The expectation that the carrier be liable for "all risks" of loss or damage is actually fairly manageable and even establishing that the carrier is liable for the full value of the cargo (be it wholesale, retail, replacement or however they want it structured) is also manageable. However, the expectation that the carrier has to be liable for damage to cargo without the value of the cargo being declared in advance of the shipment is unreasonable. The ideal of course is to have the shipper declare values on the bill of lading, subject to an agreed maximum value, as this will allow the carrier to establish an insurance solution for the transfer of risk that is priced directly against the value of the goods. If the shipper, at a minimum, is able to provide an average value and a maximum value it will allow the carrier to present a risk profile to underwriters so that a pricing model can be developed.

b. **Liability for Consequential Loss**
While the concept of consequential loss, or business interruption, is well understood by cargo underwriters, having a shipper hold a carrier liable for an undefined and/or unlimited consequential loss exposure is unrealistic from an insurance perspective. The classic example of "unreasonable" consequential loss liability comes from the 1980's Just-in-time manufacturing revolution, where carriers supplying the automotive industry were allegedly to be held liable for $1 million per minute of plant shutdown caused by a late delivery, which is a contractual liability that few carriers at the time would have actually been able to insure. Today, an undefined or unreasonable expectation around liability for consequential loss, without the establishment of a limitation of liability, combined with the removal of the force majeure provision, is almost impossible to quantify and, as such, very challenging to insure.

c. **Force Majeure provisions**
The removal of the Force Majeure provision which would allow avoidance of liability under contract in extreme situations creates a challenge for underwriters, who cannot accept liability for every type of loss. The Force Majeure provision should be maintained to allow at least an exception for loss/damage/liability that is well outside of the carrier's control – examples would include War and Strikes risks that would also represent coverage limitations for the average shipper.

d. **Liquidated Damages**
The inclusion of liquidated damages or penalties around the performance of the work was traditionally difficult to insure as these were clearly excluded from a standard bill of lading. Underwriters will still resist providing coverage for liquidated damages and penalties related to performance but there is a willingness to give consideration to coverage if the exposure is quantified and limited. However, as with consequential loss, an undefined or unlimited penalty provision, or a penalty provision that is not aligned to the value of the goods themselves, is not easily insured.

e. **Indemnity Provisions**
There have been plenty of articles on the legality and applicability of indemnity provisions in transportation agreements, in particular we reference an article written several years ago by Rui Fernandes to help define what is and is not reasonable/legal under an indemnity provision. While past indemnity provisions may have been deemed unreasonable, the need for indemnity provisions in the transportation space may actually be increasing, particularly as more brokers base their network around smaller fleets of Contract Carriers rather than working with larger national carriers. As the automobile liability insurance market tightens, both in the working and buffer layers, smaller carriers may not be able to cost effectively arrange the higher insurance limits they might have done in the past, so to save cost, many will try to carry minimum insurance levels. Recognizing that securing carriers with higher automobile liability limits is becoming problematic, brokers have also been reducing their minimum insurance expectations of the underlying carrier down from $2 million to $1 million. When this is combined with some of the nuclear decisions being made by the US courts around automobile accidents, the low limits of the actual carrier are being rapidly eroded, and the plaintiff's lawyers are looking to draw in as many deep pockets as possible. This generally will include the broker and the shipper.

For the shipper to insulate themselves from the potential liability exposure they have to what is otherwise a third party carrier related accident, these indemnity provisions place a clear expectation on the broker to respond in defense of the shipper in the event the shipper is drawn into an action arising out of the broker's selection of the underlying carrier. This is actually not an unreasonable expectation, although at some point it also needs to be recognized that there is the potential that the action being brought is also going to erode the limits purchased by the broker. As with the other clauses, having a completely open ended indemnity provision is difficult to insure. If the shipper wants better protection against being drawn into an action being brought against the carrier, they should either set a higher than standard minimum expectation of carrier automobile liability insurance (which will reduce the number and cost effectiveness of the carriers available to a broker) or contract directly with a carrier who has higher automobile liability limits. Also, regardless of underlying limits, when a retailer branded trailer is involved in an accident, there is automatically an expectation of a large settlement, even if the retailer had no involvement in the carrier selection process. To expect the broker or carrier to have the types of liability limits that the large retailer carries is perhaps unrealistic and, if required, would carry an insurance cost that could potentially make the carrier or broker uncompetitive for the services contemplated.

Other contractual requirements that are common but are not as much of an insurance issue include:

- **Freight off-set provisions and claims payment terms that are not aligned with industry standards**
  Insurance companies are not going to settle claims until they have been provided adequate opportunity to investigate the loss. An expedited claim payment term or a freight off-set term in a carrier or broker contract is not going to expedite how an underwriter assesses a loss. This can be frustrating for the carrier if they are required to settle an alleged claim from the shipper, while their insurer is not willing to expedite or even confirm payment to them within the same timeframe. For liability claims the period between the contracted payment terms and when an insurer may agree to settle a claim to the carrier can be months apart, and on a larger claim this can have an impact on the carrier or broker. There is also the risk that a claim settled by the carrier or broker may not fall within the coverage of the policy and may ultimately be declined by underwriters, leaving the carrier or broker to absorb the loss.

  The physical damage portion of an expedited claim payment requirement may potentially be addressed through a shippers' interest or cargo insurance solution, as this first party cover can respond to claims far more quickly than a cargo liability policy would.

- **Broker being contracted as the carrier**
  While many shippers may understand that there are differences between a broker and a carrier, it is not uncommon for the shipper to request that a broker sign a contract holding the broker liable as if they are a carrier. Although the broker may point out that they will endeavor to ensure that the underlying carrier meets the expectations of the shipper and that an alternative contract form may be more suitable, often the shippers will be unwilling to change their position. In these situations what might otherwise become a contingent liability on the broker becomes a primary liability – and they will need to respond directly to the shipper and then subrogate back against the carrier. From an insurance perspective, the liabilities that the broker are taking on when contracting as a carrier are manageable, so long as the above noted limitations are addressed and the broker has a tight back-to-back agreement with their underlying carriers. However, problems will occur when the broker agreements with the carrier are not aligned with the shipper's expectations – e.g. if the broker agrees to having $10 million in automobile liability coverage but only has evidence of $1 million of coverage from their carrier network, that gap in automobile liability insurance is problematic as the actual carrier moving the cargo does not have the contractually requested insurance outlined by the shipper. The broker would be in breach of contract and, while a Brokers' Liability coverage may respond to claims made by third parties against the broker for the negligent actions of the carrier, the broker will not have met their contractual obligations to the shipper, which may open them up to a breach of contract concern. In these situations, the broker may ask if we can help them arrange excess automobile liability on behalf of their carriers – although the insurance market is not generally open to providing blanket excess automobile liability insurance over an unknown group of carriers. If the broker works with a very small number of carriers this might work – but where the broker has thousands of carriers this is likely not a feasible insurance solution.

- **Request for evidence of Automobile Liability insurance to a broker**
  It stands to reason that if you don't have automobile insurance then it is very difficult to provide evidence of automobile insurance. For non-asset brokers, when the contract calls for evidence of automobile insurance, this can be a challenge to respond to, particularly if the customer takes a narrow view and does not accept a non-owned auto endorsement as an alternative. There was a time when load brokers would purchase a cheap commercial truck that would sit unused in the parking lot just so they had a vehicle to insure. The cost of arranging insurance on an unused vehicle to meet a certificate of insurance requirement was actually more cost-effective than investing the time necessary to correct the shipper contract to properly recognize the broker's role in the transaction.

Finally, as it relates to Contractual Liability, the traditional document requested by shippers as evidence of the insurance coverage that they have either specifically requested or expect to be available to respond to the contractual obligations agreed to by the carrier or broker, is often of limited value.

First, the parties issuing the certificate of insurance often have not reviewed the contract or confirmed that the coverage actually meets the expectations of the shipper under the contract agreement.

The certificate evidences that the requested policies have been arranged and that the required limits are available, but give no indication that the coverage is actually suitable for the contract. To this end, an insurance certificate is at best evidence of coverage in force at the date of issue but to fully understand how the coverage may respond, policy forms would need to be reviewed including terms and conditions, coverage enhancements/limitations, endorsements and covered/excluded vehicles. Examples of common certificate misses include:

- A Symbol 7 reference, which designates "specifically described autos" and without review of the vehicle schedule on the policy, evidences coverage will not apply to an unscheduled vehicle. There are instances where a multiple unit operator will list one vehicle on a policy and use a certificate as evidence for multiple units, i.e. "Multi Exposure."

- Hired and Non-Owned coverage may limit coverage to personal vehicles and is generally not intended to address commercial vehicles.

- Policy definitions around ownership of short and long term leased vehicles, temporary and permanent replacement will vary between underwriters and will significantly alter coverage.

Second, there is very little control over the validity of the certificate itself. While it follows an industry standard format, such as the Acord format, there is little to prevent a certificate from being fraudulently issued. Even if using a third party certificate management service, the validation generally focusses on the confirmation of limits and renewal dates but not how the coverage will respond to specific contractual situations. As such, certificates of insurance, while a "standard" requirement for transacting business, are of limited value. In fact, the majority of reputable carriers or brokers will have adequate insurance to address their operational exposures even if a certificate is not requested, while a less reputable carrier or broker, who does not have adequate insurance, has the potential to produce a fraudulent certificate and the shipper is not going to realize this until after a loss has taken place. Although a controversial suggestion, as an industry perhaps we could effectively do away with traditional certificates of insurance and all of the frictional costs related to the collection and review of these documents, relying instead on the terms of the contract alone and the expectation that the contracting parties will perform and insure their performance under the contract as may be suitable. Of course as we move to blockchain transactions and smart contracts, by taking out more of the coverage variables in contract terms, the need for a paper based evidence of insurance will quickly disappear anyway.

Third and finally, from a contractual liability perspective, there is very little benefit to adding a shipper as an additional insured under a cargo liability policy. The shipper should not reasonably expect that the broker or carrier's insurers will automatically pay a loss under the policy – just as requiring that the insurers acknowledge sight of a contract will not ensure that all aspects of the contract will be covered by the insurance policy. Certainly the addition of a requirement that an underwriter have sight of a contract which includes unlimited or open ended liability for loss/damage to goods cannot ensure that the underwriter will pay any and all losses experienced by the shipper.

BROKERS' LIABILITY

We now move from Contractual Liability and look at the specific liability of a transportation intermediary, while building on the Indemnity Provisions expected by shippers. Freight Brokers Liability is an emerging risk in the brokerage space that, although not technically new, has not been as well addressed from an insurance perspective as it should be.

Freight Broker Liability: Freight brokers are in some ways the first disruptors of the transportation industry. Freight brokers traditionally worked in an unregulated space simply matching loads to carriers, actively avoiding liability and certainly not accepting contracts or making any warranties around the fitness or suitability of the carriers they were engaging. In recent years, however, the broker's role in the transportation industry has grown. Smaller brokers have developed into massive operations, through-putting billions of dollars in freight receipts, becoming much larger than many of the carriers that they connect with their shipper customers.

In addition, the majority of asset-based carriers also have a brokerage arm to ensure that they can provide their customers with a more complete national and international service.

To battle thin margins, brokers have also become more willing to partner with shippers, delivering more customized services, and of course accepting greater levels of contractual liability (as discussed already). This increase in size, along with the expansion of role, has put the broker in a challenging position. When an underlying carrier is involved in an incident, it is becoming more likely that, if there was a broker involved in the transaction, they will be drawn into the claim.

Although negligent hiring and vicarious liability are the common allegations, in many cases the action against the broker is unfounded or weak. However, even the basic defense of an unfounded claim may cost hundreds of thousands of dollars and, more often, courts are making unfavorable decisions against the broker to ensure the plaintiff is adequately compensated.

In situations where brokers are using independent contractors, the underlying carrier's insurance coverage may be limited. As the automobile liability market has hardened, smaller carriers have reduced the limits they purchase, and brokers have accepted these reduced limits, which puts them at a greater risk of being drawn into a third party claim.

From an insurance perspective, there has been some misunderstanding around the appropriate coverages a broker should carry to address the risks related to being drawn into a third party action against a carrier with whom they assisted in coordinating freight.

As mentioned earlier under Contractual Liability, to address the automobile liability requirements imposed upon them under contract, they might arrange to have an automobile liability policy on a vehicle they may not use. In the US, that automobile policy would likely have a non-owned automobile coverage extension. In Canada the non-owned automobile extension is often included under the General Liability policy.

For a number of years, and likely in a number of cases, brokers may have called upon the non-owned automobile coverage under either an Auto or GL policy to respond to the defense of actions into which they are drawn – with the presumed interpretation that the action was based around the broker's "use" of the carrier's vehicle for the movement of cargo.

There are challenges with using a non-owned automobile provision to cover these exposures as the primary intention of the extension of coverage is to address the insured's use of rental vehicles, examples of which include the use of rental vehicles by sales people, or the short term rental of a replacement commercial vehicle that is being driven by the insured's employee driver, or the insured's contracted driver. However, in a properly structured brokerage relationship, the driver of the vehicle is neither an employee nor a contracted driver.

The application of coverage under a non-owned automobile provision is also problematic, as it would be intended to sit excess of any primary coverage in place for the actual driver – and, on this basis, the coverage is sometimes called contingent auto, or contingent non-owned auto. However, when the broker is not tied or related to the carrier, the action being made against the broker is not contingent, nor is it excess. The last thing that the broker wants to rely on is the defense being put up by a carrier who only has $1 million in automobile liability insurance in a situation where the plaintiff's claim could be several million dollars.

Freight Broker's Liability (or Broker's Liability) coverage is a primary insurance coverage intended to address situations where the broker is drawn into an action as a result of an incident involving a carrier that handled freight brokered by the insured. As a primary cover it responds on behalf of the broker and it specifically does not provide coverage for the carrier. It is not a contingent cover, nor does it sit excess the carrier's liability, and it may subrogate back against the carrier, and so many astute brokers will have an indemnity provision with the carriers they use to allow for this.

For coverages scheduled up into an excess or umbrella program, we often see the broker's liability sitting on its own as many traditional excess markets do not want to sit over the broker's liability exposure. This was highlighted two years ago as Lexington exited the Broker's Liability market and Zurich and AIG moved out of the buffer layer space. In essence, broker's liability acts like a buffer layer coverage where the actual carrier's primary is not adequate to respond to the claim being made against them.

Broker's Liability coverage should be arranged across the entire operation. Because coverage is not "cheap" there is sometimes a perception that by applying coverage to only a portion of the operations the broker can reduce the cost of coverage. Keep in mind, however, that a claim can arise from any of the carriers that the broker may employ – not just the "small" carriers or from a niche part of the brokerage business.

In addition, the coverage form for the Broker's Liability needs to be broad. Early forms and some current forms place expectations or warranties on the broker to ensure that the underlying carrier has a certain level of automobile liability coverage, and if this warranty is breached, may not respond on behalf of the broker. This effectively defeats the purpose of the coverage and, as such, forms that require a certain level of due diligence in the carrier selection process but do not warrant there be a minimum level of coverage with the carrier may be deemed more attractive.

Once a broker understands their exposure and the coverage provided by the broker's liability form, they are faced with the difficult question of how much limit should be purchased. Since the exposure should primarily be defense, a high limit may not be necessary. At the same time, however, for larger brokers, having higher limits may be necessary to address the decisions they might face as a deep pocket.

CHANGING TECHNOLOGY AND THE IMPACT ON AUTOMOBILE INSURANCE

Looking forward at the potential changes that the insurance industry is likely to face over the next five to 15 years, technology is clearly going to have a massive impact on the risk profile of transportation industry and automobile insurance. As noted at the start of this paper, autonomous vehicles are going to change liability claims; simply put, if vehicles don't crash, a huge part of the insurance industry will become unnecessary. In the US, automobile insurance makes up approximately 40% of the total market premium. From a dollar perspective, it is roughly $247 billion dollars out of a total market premium of $611 billion, with the next largest individual coverage line being homeowners insurance at $91 billion* (NAIC 2016 Key Facts and Market Trends). If vehicles are 99.9% less likely to be involved in an accident, the reduction in claims will lead to a massive reduction in premium. With the anticipated reduction in accident frequency and a substantive reduction in loss costs, the insurance industry will be facing even greater challenges around where to deploy capital, and will be forced to significantly reduce the cost structure that is currently in place supporting the industry – including underwriting, administration, claims management, and of course certificate issuance. There is, of course, the short term possibility that, during the transition to autonomous vehicles, there may be an increase in loss severity, including punitive jury awards against the manufacturers of autonomous vehicle technology, as well as challenges around how autonomous and non-autonomous vehicles will interact and be insured – but this can only last for a short period before fully-autonomous vehicles become legislated in the best interest of society.

In addition, as artificial intelligence develops in the insurance space, the pricing of risk will become more efficient, and more accurate, reducing the need for underwriters and ensuring there is less variance between insurance markets. With less pricing variances, the selection process of coverage will be less labor intensive, reducing the requirement for a broker to assist with the insurance transaction. Some estimates suggest that the insurance industry will be able to shed approximately 60% of current staffing as the business of rating and delivering insurance becomes more commoditized and automated.

On the claims front, which is also currently labor intensive, blockchain will assist in creating claims settlement efficiency, with significantly reduced debates with respect to validation of the parties to be paid, along with less confusion around expectations under purchase agreements, including a more specific understanding of liabilities of the parties under contract.

In addition, smart contracts will ensure clarity of liability, forcing issues such as the financial obligations of a carrier in the event of a loss to be pre-defined. These more specific pre-defined obligations will be tied under contract into the insurance coverage of the parties involved in the transaction, eliminating questions around whether or not there is the correct coverage in place, and thankfully ending the need for certificates of insurance.

CONCLUSION

As we see change taking place at an ever increasing pace in both the way goods are moved and the expectations being placed on the parties involved with the movement of goods, the insurance industry is going to be challenged to keep up. The coverage structures of the past may not be suitable for the contractual and operational exposures of the future.

For the insurance industry to provide a valued service to the transportation industry, we will see changes in how insurance coverage responds to the expectation of shippers, who are not likely to go back to accepting "traditional" limitations. We will need coverage to address the changing way goods are moved, recognizing that the brokerage of services to a network of independent contractors, similar to the ridesharing model of creating a network of independent drivers, is going to continue to grow until it is disrupted by the wider acceptance of autonomous vehicles. We will also need to see changes in the way insurance interacts with new technologies, including concepts around continually adjusting coverage based on AI, and improved contract certainty through smart contracts and blockchain.

Fortunately, for the near term at least, there will continue to be risk in the transportation of goods. However, as expectations shift regarding how the responsibility for those risks are managed, either through contract, court decisions, or changing technology, the insurance industry is going to be challenged to keep up.

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